TRUTH IN LENDING REIMBURSEMENT

IN THIS APPENDIX

OVERVIEW

This Appendix provides information relating to the identification of reimbursable Truth in Lending violations, reimbursement calculations, and for the determination corrective action.

Objective(s)

The objectives of these procedures are to provide:

General guidance for identifying and calculating reimbursable violations

Proper treatment of these violations in the Report of Examination

REIMBURSEMENT GUIDELINES

In dealing with Truth in Lending reimbursement, the examiner needs to be familiar with the following guidance:

Truth in Lending Act

"Administrative Enforcement of the Truth in Lending Act – Restitution", FFIEC Joint Statement of Policy

FFIEC's Questions and Answers on Truth in Lending Reimbursement (Q&A)

REIMBURSEMENT GUIDELINES (cont'd)

Regulatory Actions

Section 108(e)(2) of the Truth in Lending Act (Act) directs that the FDIC shall require "adjustments" (monetary reimbursement) to consumers for understatements of annual percentage rates (APR) or finance charges (FC). Unless other statutory or regulatory exemptions are met, the FDIC is required to seek reimbursement and may not waive or grant relief from reimbursement. If an institution does not voluntarily comply with the law and make reimbursement, Section 108(e)(4) of the Act authorizes the FDIC to order institutions to make monetary adjustments to the accounts of consumers where an APR or FC was understated.

In 1980, the FFIEC adopted a Joint Statement of Policy entitled "Administrative Enforcement of the Truth in Lending Act – Restitution" (Policy Guide) that summarizes and explains the restitution provision of the Act. The Policy Guide is reproduced in FDIC's looseleaf Rules and Regulations service under the "FDIC Statements of Policy" tab.

The Policy Guide states that, in general, the FDIC must require (and may order) restitution when understatement of the cost of borrowing results from ***a clear and consistent pattern or practice of violations, gross neglect, or a willful violation*** intended to mislead the consumer. This parallels the reimbursement requirements of Section 108(e)(2) of the Act. In such instances, a file search may be requested to detect loans containing specific problems requiring reimbursement. The request is made by the Regional Office or, if permitted by Regional policy, may be made by the Examiner-in-Charge (EIC).

While the Act and Policy Guide set the definitive general principles as to when reimbursement is required, the FFIEC's interpretive Questions and Answers on Truth in Lending Reimbursement (Q&A) regarding the Policy Guide provide guidance as to applying the principles to given situations. The Q&A are included in this Appendix. The Q&A were originally issued in 1980, with additional interpretations added from time to time.

Requests for Relief from Reimbursement

Historically, the FDIC has treated a request made by non-member banks seeking relief from making reimbursement under the Truth in Lending Act, 15 U.S.C. §1601 et seq. (TILA), as an application under its regulations. The Board has delegated authority to the Director of the Division of Compliance and Consumer Affairs (DCA) to grant or deny these requests. The Director has further delegated this authority to the Regional Directors (DCA), but only to deny requests where the amount of reimbursement totals less than $25,000.

REIMBURSEMENT GUIDELINES (cont'd)

Requests for Relief from Reimbursement (cont'd)

The TILA grants the enforcement agencies very little discretion to grant relief from reimbursement for violations. Because of this limited discretion, the FDIC has not been able to grant relief in many instances. From 1991 through 1996, a total of 63 requests were reviewed at the Washington level and only one of these requests was granted. In that one instance, it was determined that the cited violation was, in fact, not a violation of Regulation Z.

Should a nonmember bank wish to pursue a request for relief, even though there is a strong likelihood that a request will not be granted, the request will be processed within established time frames (see FIL-26-96, "Regulatory Responsiveness," dated May 6, 1996, concerning application processing time lines):

> Requests that can be processed under delegated authority by the Regional Director and Regional Counsel must be completed within 60 days after receipt unless the institution has agreed in writing to an extension of time to make the determination.
>
> Requests requiring action by the Washington Office will be referred by the Regional Office to the Washington Office within 45 days of receipt. A decision will be made within 45 days of receipt in Washington.

Legal Background

Section 108(e) of the TILA,[1] which governs enforcement of TILA, provides a very specific framework for requiring agency action on restitution. Once the FDIC determines that a disclosure error involving an inaccurate APR or finance charge has occurred, and that the error has resulted from "gross negligence," or a "clear and consistent pattern or practice of violations," the agency **shall require** an adjustment unless one of four stated exceptions applies, in which case the agency **need not require** an adjustment.[2] If the exceptions apply, or in cases of similar disclosure errors, an agency **may require** an adjustment.

The use of the terms "shall require an adjustment," "need not require an adjustment" and "may require an adjustment" within the same section of the statute suggests that Congress intended the term "shall require" to be mandatory. The Congress used the word **must**, indicating the compulsory nature of its direction that an agency enforce the TILA with regard to the specific kinds of violations enumerated, as contrasted with the agency's discretion to order restitution in other situations:

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[1] Consumer Credit Protection Act, tit. 1§108(e), Pub. L. No. 90-321, 82 Stat. 150 (1968), as amended by the Truth in Lending Simplification Act, Pub. L. No. 96-221, tit. VI, §608, 94 Stat. 132 (1980)(codified at 15 U.S.C.§1607(e)).

[2] 15 U.S.C. §1607(e)(2). Where there is a "willful violation which was intended to mislead the person to whom credit was extended" the exceptions do not apply.

"Where the violation resulted from a pattern or practice of violations,

REIMBURSEMENT GUIDELINES (cont'd)

Requests for Relief from Reimbursement (cont'd)

gross negligence, or a willful violation intended to mislead, an agency must, subject to the restrictions discussed below, order restitution to the consumer designed to assure that the consumer pays no more than the lower of the finance charge or annual percentage rate actually disclosed...In the case of violations not falling under any of the above criteria, each agency may in its discretion order restitution." Id. at 12; accord verbatim, S. Rep. No. 368, 96th Cong., 1st Sess. 26 (1979).

There are four instances where the FDIC has discretion to waive reimbursement. Three of these exceptions are straightforward and are fact specific. It would be unusual to find a bank which could successfully assert one of these exceptions as a defense, since it is unlikely that restitution would have been ordered in the first place as FDIC examiners carefully evaluate whether any of the exceptions exist before requesting that a bank make restitution.

The first three exceptions are where:

1. The error involves a fee or charge that would otherwise be excludable in computing the finance charge.

2. The error involved a disclosed amount which was 10 percent or less of the amount that should have been disclosed and either the annual percentage rate (APR) or finance charge was disclosed correctly; or

3. The error involved a total failure to disclose either the APR or finance charge.[3]

The fourth exception is the one most frequently cited by an institution in requesting relief. It is the one that is most difficult to meet since it contains four elements, **all four of which must be met** for the exception to apply. The conditions are that:

the error resulted from a unique circumstance

the disclosure violations are clearly technical and non-substantive

the disclosure violations do not adversely affect information provided to the consumer; and

the disclosure violations have not misled or otherwise deceived the consumer.[4]

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3 15 U.S.C. §1607(e)(2)(A)-(C).

4 15 U.S.C. §1607(e)(2)(D).

The legislative history of TILA does not define the term "unique circumstance"; however, the FDIC considers the term "unique" to have the traditional meaning,

REIMBURSE-MENT GUIDELINES (cont'd)

Requests for Relief from Reimbursement (cont'd)

including "unusual," "atypical," and "infrequent." Where violations involving the finance charge and APR are concerned, the requirement that the error be "clearly technical and nonsubstantive" generally cannot be met. Technical and nonsubstantive violations do not include those which could affect the outcome of a borrower's decision in credit shopping. See S. Rep. No. 368, 96th Cong., 1st Sess. 16-17 (1979). Congress intended the "technical and non-substantive" exception to be construed very narrowly for use in such situations as clerical or computer errors.[5]

Similarly, where there is an understatement of the finance charge or APR, it is **unlikely** that there will be "no adverse effect on information provided to the consumer" and that the error **would not have** "misled or otherwise deceived the consumer." Thus, it is extremely rare that the conditions contained in the fourth exception are ever met. For example, some recent requests by institutions seeking relief from having to make reimbursement have included some of the following reasons as a defense that the FDIC determined to be unacceptable:

Consumers did not pay any additional amount because of inaccurate disclosures

Impact on the institution's reputation in its community

Size of the institution

Consumers signed the credit life insurance application, but did not affirmatively indicate a desire to purchase the insurance

Provider of form/software purchased by institution gave erroneous advice

Consumers were given new disclosures, but were not provided monetary reimbursement

Examiners did not cite violation at previous examination

[5] Many violations involve credit life insurance disclosures. Such errors were considered important enough to Congress to form the basis of amendments made to the original version of TILA. See S. Rep. No. 368, 96th Cong., 1st Sess. (1979).

Procedures for Making a Request

REIMBURSEMENT GUIDELINES (cont'd)

Requests for Relief from Reimbursement (cont'd)

If an institution decides to make a request for relief from reimbursement, it should do so within 30 days of receipt of the report of examination containing the request to conduct a file search and make restitution to affected customers. The request should be directed to the attention of the Regional Director (DCA) and must address the statutory factors contained in Section 108(e) of the TILA. The Regional Director will notify the institution of the receipt of the request and that pending a final determination, the institution is not required to complete corrective action on the restitution request.

When restitution must be made, the FDIC expects the institution to carry out the reimbursement to the customer expeditiously according to the Joint Statement of Policy on Restitution adopted on July 11, 1980. When lump sum payments to consumers are required to be made, they must be provided to the consumer either by official check or a deposit into an existing unrestricted consumer asset account, such as an unrestricted savings, checking or NOW account. If, however, the loan is delinquent, in default, or has been charged off, the creditor may apply all or part of the reimbursement to the amount past due, if permissible under law.

There have been instances where institution personnel have inappropriately requested consumers to return reimbursement checks to the institution. This, and any like practice, is not permissible, and the FDIC views any such attempts to prevent unrestricted access by the consumer to reimbursement proceeds as a serious breach of fiduciary duty as well as a violation of law and regulation. These violations will be subject to enforcement actions, including but not limited to, assessment of civil money penalties, orders to cease and desist, and possible removal/prohibition orders.

Required Corrective Action

Under provisions of the Act, a financial institution will generally have no civil liability (Section 130(b)) or regulatory liability (Section 108(e)(6)) if it takes two affirmative corrective actions. Within 60 days of "discovering" an error (but before institution of a civil action or receipt of a written notice of error from a consumer), the financial institution must both:

Notify the consumer of the error, *and*

Reimburse the consumer for overcharges

An error is "discovered" if the institution either identifies the error through its own procedures or if it is disclosed in a written examination report.

If the financial institution attempts to correct a disclosure error by merely redisclosing the required information accurately, without reimbursing the consumer, correction has not been effected. Consumer reimbursement is an inseparable part of the correction action.

REIMBURSEMENT GUIDELINES (cont'd)

FFIEC Q&A 11 indicates that the institution must make a cash payment or a deposit into an existing unrestricted consumer asset account, such as an unrestricted savings or NOW account. However, if the loan is delinquent, in default, or has been charged off, the creditor may apply all or part of the reimbursement to the amount past due, if permissible under law.

Required Corrective Action (cont'd)

Corrective Action Period

Open-end credit transactions will be subject to an adjustment if the violation occurred within the two-year period preceding the date of the current examination.

Closed-end transactions will be subject to an adjustment if the violation resulted from a clear and consistent pattern or practice or gross negligence where:

> There is an understated APR or understated FC, and the practice giving rise to the violation is identified during a current examination. Loans containing the violation which were consummated since the date of the immediately preceding examination are subject to an adjustment

> There is an understated APR or understated FC, the practice giving rise to the violation was identified during a prior examination and is not corrected by the date of the current examination. Loans containing the violation which were consummated since the financial institution was first notified in writing of the violation are subject to an adjustment. (Prior examinations include any examinations conducted since July 1, 1969.)

Variable-rate transactions consummated after September 30, 1984 where the initial rate is discounted from the index rate used for later adjustments and results in a clear and consistent pattern or practice or gross negligence involving an understated APR or understated FC will be subject to an adjustment.

Each closed-end credit transaction containing a willful violation intended to mislead the consumer consummated since July 1, 1969 is subject to an adjustment.

For terminated loans not previously identified as having an understated APR or FC, an adjustment will not be ordered if the violation occurred in a transaction consummated more than two years prior to the date of the current examination.

REIMBURSEMENT GUIDELINES (cont'd)

Illustrated below are the tolerances to be applied in calculating the amount of the adjustment to a consumer's account.

> For loans involving a willful violation and containing understated APR violations, a tolerance of 1/8% applies

Tolerances and Calculation of Reimbursement

For loans granted April 1, 1982 or later which contain understated APR violations which did not result from a willful violation:

	Amortized 10 Years or Less	Amortized Over 10 Year
Regular Loans	1/4	1/8
Irregular Loans	1/4	1/4

Nondisclosure of the APR or FC

Nondisclosure of the APR or FC
4. If the APR was not disclosed, use the contract rate.
5. If the contract rate was not disclosed, use the actual APR (calculated by the examiner) less one percent. For first lien mortgage loans, use the actual APR less ¼ percent.
6. No adjustment will be ordered where a FC was not disclosed.

Improper Disclosure of Insurance

CREDIT LIFE, ACCIDENT, HEALTH, OR LOSS OF INCOME INSURANCE
In general, treatment of credit insurance premiums is covered by Sections 106(b) and (c) of the Act and by Section 226.4 (d) (1) of Regulation Z. It is also covered in Paragraph 4(d) of the Federal Reserve's Official Staff Commentary to Regulation Z.

Required Insurance Coverage

Credit insurance coverage required by the institution as a precedent to obtaining the loan is a cost of credit and must be included in calculations for the APR and FC. Failure to do so may lead to an understated APR and FC.

REIMBURSE-MENT GUIDELINES (cont'd)

When credit insurance coverage is not required by the financial institution as a precedent to obtaining a loan, the cost of the insurance premiums are not a cost of credit. They may be excluded from APR and FC calculations only if full credit insurance disclosures are properly made. Failure to do so may lead to an understated APR and FC.

Optional Insurance Coverage

Credit insurance disclosures must be made in writing. Verbal disclosures are not acceptable. *All* three elements of the disclosures must be present:

1. A statement that the insurance coverage is optional and is not required by the financial institution, and

2. The cost of the premium for the initial term of the insurance coverage, and

   Cost

   In most closed-end loans, insurance must be disclosed as a total dollar amount. However, insurance may be disclosed on a unit-cost basis (for example, $1 per $1,000 of the amount financed):

   -- Where the insurance plan limits the total amount of indebtedness subject to coverage, or

   -- Involving mail or phone transactions without face-to-face or direct telephone solicitation

   See Paragraph 4(d)(4) of Regulation Z's Official Staff Commentary.

   In open-end credit, insurance is disclosed on a unit-cost basis

   Term

   If the term of the insurance is less than that of the transaction, the term of the insurance coverage must also be shown

   If the term is unclear, such as when premiums are paid periodically and the consumer is under no obligation to continue making the payments, premiums may be disclosed on the basis of a one-year period, but the one-year period must be clearly labeled

   Refer to Paragraph 4(d)(11) of Regulation Z's Official Staff Commentary.

3. The customer's signature or initials signifying an affirmative desire for the optional insurance coverage.

REIMBURSE-MENT GUIDELINES (cont'd)

Separated disclosures are acceptable. The three required credit insurance disclosures are not required to be located in the "Federal Box" or even on the primary Truth in Lending disclosure form. In addition, they do not need to be grouped together, or even appear on the same page. *Refer* to Footnote 38 to Regulation Z.

Grouping of Insurance Disclosures

Unacceptable Alternatives

Substitute disclosures do not satisfy Truth in Lending requirements. For instance, a consumer's signature at the bottom of the Truth in Lending disclosure form, acknowledging receipt of the form, is not an acceptable substitute for a separate signature or initial specifically affirming a desire for the optional insurance coverage. In a similar manner, coverage of the insurance premiums in the itemization of the finance charge does not substitute for the requirement to state separately the cost of the insurance within the credit insurance disclosure. Likewise, disclosure of separate elements of the disclosures on other forms, such as itemization of the premiums on a HUD-1 form for mortgages, or signing an insurance company’s application form, do not satisfy the credit insurance disclosure requirements of Truth in Lending.

Credit Insurance Legal Opinion

In a series of related opinions dated January 29, February 8, and September 5, 1985, the Legal Division indicated that understated APR's and FC's stemming from faulty credit insurance disclosures were reimbursable violations that, by statute, required reimbursement. The opinions indicated that such violations were substantive, and not merely technical, violations. The opinions further stated that, except for the statutory exemptions in Section 108 of the Act, the FDIC must mandatorily require the financial institution to reimburse consumers and could not grant relief from reimbursement.

Obvious Errors

When either the APR or FC was understated and the other was correctly disclosed, Section 108(e)(2)(B) of the Act states that no adjustment will be required if the understated APR or FC was "10 percent or less of the amount that should have been disclosed." This means that the APR or FC is understated by 90% or more of what should have been disclosed, in order to qualify for the "obvious error" exemption from reimbursement.

REIMBURSEMENT GUIDELINES (cont'd)

Current Examination Legal Opinion

Section 108(e)(3)(i) of the Act provides that reimbursement shall not be required by institutions ". . . except in connection with violations arising from practices identified in the current examination and only in connection with transactions that are consummated after the date of the immediately preceding examination ...." This led to various interpretations that FDIC would be "time-barred" from seeking (or ordering) uncompleted reimbursement found in the preceding examination once a subsequent examination took place.

In a March 28, 1989 opinion, the Legal Division concluded that such a time-bar does not apply to this situation. The thrust of the opinion is that the statute's reference to "the current examination" deals with the examination during which the reimbursable violations were found. This examination always remains the "current examination", for purposes of curing the reimbursable violations, until reimbursement is accomplished.

As a result, there is no statutory "time-bar" prohibition against conducting subsequent compliance examinations or visitations which cover Truth In Lending. However, in order to avoid the frequent raising of this defense in connection with pending relief from reimbursement cases, reexaminations should be deferred during the pendency of the request, if possible.

Effect of Reimbursement on Bank Capital

Often, a financial institution attempts to use the impact of reimbursement on its capital as a defense against having to make any reimbursement at all. This is not an acceptable defense.

Section 108(e)(3)(A) indicates that even if reimbursement "would have a significantly adverse impact upon the safety and soundness" of the institution, full reimbursement is still required. The only option permitted to the FDIC by the Act in such circumstances is to "permit the [financial institution] to make the required adjustment in partial payments over an extended period of time which the FDIC considers reasonable."

Other Unacceptable Defenses

Since provisions of the Act provide a "decision tree" indicating those points which the FDIC must consider in granting relief from reimbursement, anything outside of the Act's provisions is an unacceptable defense. Some of the more common unacceptable defenses are:

Size of the institution

Impact of reimbursement on the institution's reputation

Previous examinations did not find the violation

REIMBURSE-MENT GUIDELINES (cont'd)

Other Unacceptable Defenses (cont'd)

Examiners previously gave erroneous advice

Redisclosure was made to consumers (but reimbursement was not)

Pattern Or Practice

Reimbursement is required by a creditor (financial institution) whenever a "pattern or practice" of reimbursable violations occurs. The term "pattern or practice" is set forth in the Truth in Lending Act. However, a pattern or practice is not defined by the Act, Regulation Z, the Federal Reserve's Staff Commentary to Regulation Z, the Policy Guide, or FFIEC's interpretive Questions and Answers. Therefore, it is something of a term of art, which must be applied to individual situations according to the facts and circumstances present.

A pattern or practice occurs when errors stem from a common cause, usually within one type of consumer credit which often has certain common characteristics. For instance, failure to obtain customer signatures for credit insurance in mortgages with credit insurance coverage.

A pattern or practice is not represented by a specific number of loans, nor a specific percentage. If an institution makes one loan of a certain type and with certain characteristics, and that one loan has an understated APR or FC beyond permissible tolerances, than that one loan may represent a pattern or practice.

In deciding Truth In Lending cases requesting relief from reimbursement, FDIC's Board of Directors and former Board of Review have ruled that a pattern or practice may occur in one branch of an institution, or through the actions of one officer in an institution.

EXPLANATION OF FINANCE CHARGE

FINANCE CHARGE = DOLLAR COST OF CONSUMER CREDIT It includes any charge payable directly or indirectly by
the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit.

FINANCE CHARGES

ALWAYS INCLUDED

- Interest
- Transaction fees
- Loan origination fees
- Premiums for credit guarantee insurance (Private Mortgage Ins/ FHA insurance)
- Charges imposed on the creditor for purchasing the loan which are passed on to the consumer
- Discounts for inducing payment by a means other than credit
- Additional example of finance charges fee for preparing TIL disclosure statement, RE construction inspection fee or a fee for a tax service policy
- Mortgage broker fees paid by borrower

INCLUDED UNLESS CONDITIONS MET

- Premiums for credit life, A&H, loss of income insurance → Insurance not required; disclosures are made and consumer authorizes
- Premiums for property or liability insurance → Consumer selects insurance company and disclosures are made
- Premiums for single interest insurance (VSI) → Insurer waives all right of subrogation; consumer selects insurance company and disclosures are made
- Security interest charges such as filing fees (or insurance in lieu of or applicable notary fees) → The fee is for lien purposes, prescribed by law, payable to a public official and is itemized and disclosed
- Appraisal and credit report fees → Application fees, if they are charged to all applicants. At the creditor's option, the fee may include any appraisals or credit report charges
- Taxes levied on security instruments or documents → If taxes are precondition for recording the instrument

CHARGES EXCLUDED IF CONDITIONS ARE MET

ANY LOAN

- Insurance not required; disclosures are made and consumer authorizes
- Consumer selects insurance company and disclosures are made
- Insurer waives all right of subrogation; consumer selects insurance company and disclosures are made
- The fee is for lien purposes, prescribed by law, payable to a public official and is itemized and disclosed
- Application fees, if they are charged to all applicants. At the creditor's option, the fee may include any appraisals or credit report charges
- If taxes are precondition for recording the instrument

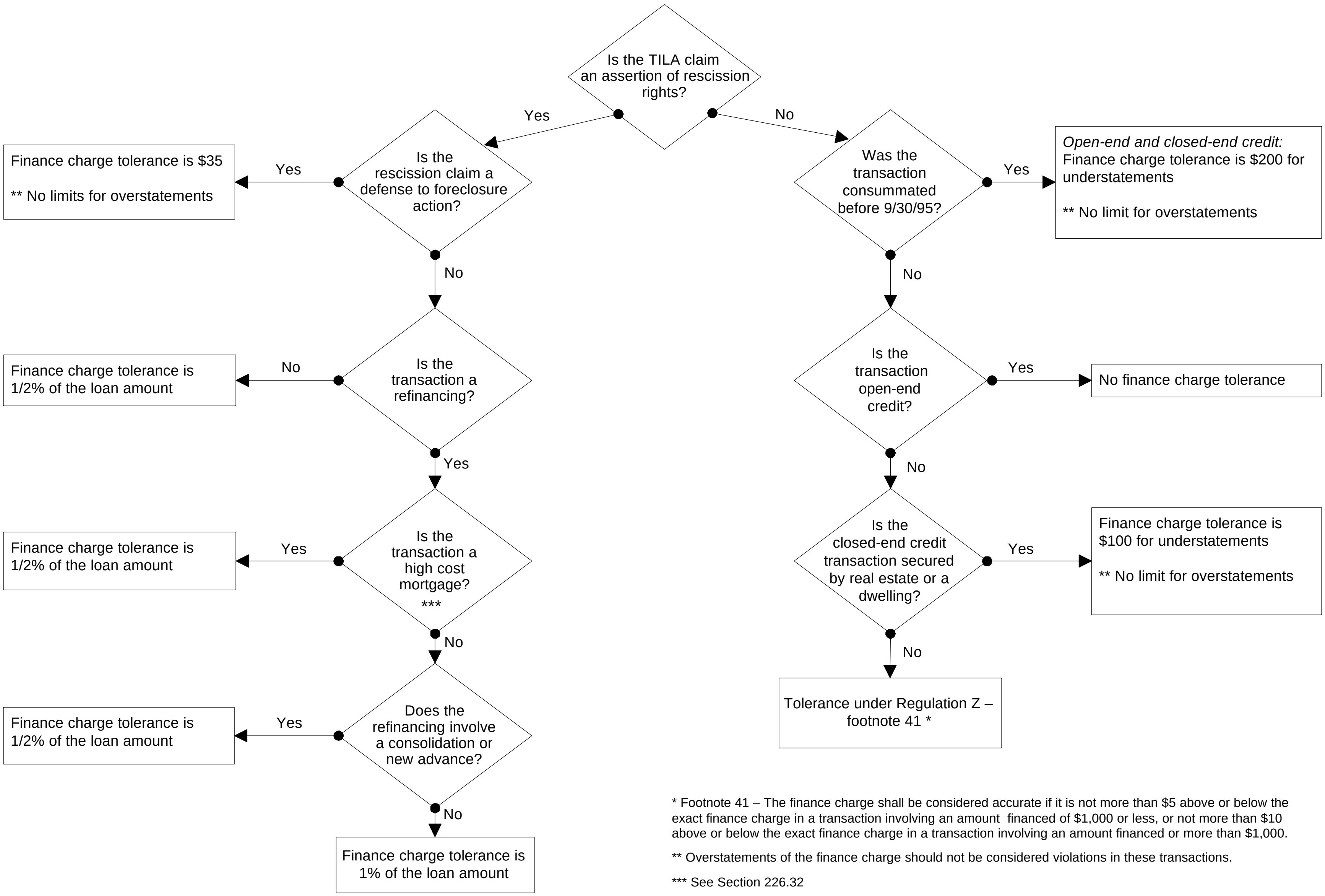
RE SECURED OR REM

- Fees for title insurance/ examination, property survey, pest infestation or flood hazard inspection (prior to closing)
- Fees for preparation of loan related documents
- Amounts required to be paid into escrow if not otherwise included in the finance charge
- Notary fees
- Appraisal and credit report fees

CHARGES THAT ARE ALWAYS EXEMPT

- Charges payable in a comparable cash transaction
- Late fees
- Overdraft fees not agreed to in writing
- Seller's points
- Participation or membership fees
- Discount offered by seller to induce payment by cash or other means not involving the use of a credit card
- Interest forfeited as a result of interest reduction required by law
- Charges absorbed by the creditor as a cost of doing business
- Charges imposed by a non-creditor for services not required by (and the charges are not retained by) the creditor

Post-Rodash Amendments
Finance Charge Tolerances Under Truth in Lending and Regulation Z



* Footnote 41 – The finance charge shall be considered accurate if it is not more than $5 above or below the exact finance charge in a transaction involving an amount financed of $1,000 or less, or not more than $10 above or below the exact finance charge in a transaction involving an amount financed or more than $1,000.

** Overstatements of the finance charge should not be considered violations in these transactions.

*** See Section 226.32

QUESTIONS AND ANSWERS REGARDING JOINT INTERAGENCY STATEMENT OF POLICY FOR ADMINISTRATIVE ENFORCEMENT OF THE TRUTH IN LENDING ACT - REIMBURSEMENT ISSUED BY THE FFIEC ON JULY 11, 1980

NOTE: The Statement of Policy is included in the FDIC Statements of Policy, Volume 2 of FDIC's Rules and Regulations, page 5049.

1. Q Do the enforcement standards and accuracy tolerances in the Policy Guide supersede the requirements of the Truth in Lending Act (Act) and Regulation Z?

   A No. The Policy Guide applies only to agency enforcement procedures. It does not alter a creditor's responsibility to comply fully with all the requirements of the Act and Regulation Z, including finance charge and annual percentage rate accuracy requirements.

2. Q When violations are discovered in purchasing or assigned loans, which are initially payable to a person other than the financial institution, will the financial institution be ordered to make the necessary adjustments to the accounts of affected customers?

   A No. The financial institution is not the creditor, even if the obligation by its terms is initially payable to a third party and simultaneously assigned to the financial institution. The violations will be referred to the creditor's enforcing agency.

3. Q How should the *de minimus* rule be applied in closed-end credit transactions?

   A The *de minimus* rule should always be applied to the amount of reimbursement calculated under the "lump sum method" of reimbursement as to the maturity date of the transaction, regardless of which reimbursement method is ultimately used by the creditor.

4. Q If the creditor must itemize the amount financed but fails to disclose or understates the prepaid finance charge, will reimbursement be required?

   A No. This violation of Regulation Z will require prospective corrective action only, assuming the prepaid finance charges are properly included in the computation of the APR and finance charge.

5. Q If APR or finance charge disclosures not required by Regulation Z have been made, will reimbursement be required when such optional disclosures are understated?

   A No. However, errors in disclosures not required by Regulation Z for a particular transaction are violations of either 12 CFR 226.5(a)(1) or 12 CFR 226.17(a)(1), both of which require that credit disclosures be made clearly and conspicuously.

6. Q Must reimbursements resulting from understated finance charges always be made as a single "lump sum" amount?

   A No. Reimbursements resulting from the creditor's failure to include prepaid finance charges in the total finance charge must always be refunded as a "lump sum" payment, but reimbursements resulting from failure to include finance charge components that accrue over time may be prorated on a straight-line basis (no time value) over the life of the loan and refunded under the lump sum/payment reduction method.

7. Q How will the Policy Guide apply to loans for which no disclosure statements are on file?

   A If there is no evidence that the creditor furnished disclosures or if there is a preponderance of evidence that disclosures containing violations subject to reimbursements were destroyed before the record retention period expired, either violation will be treated as a failure to disclose the APR.

   The creditor will be given the opportunity to substantiate the claim that an accurate disclosure was made before final action is taken. The absence of compliance documentation will be viewed relative to known practices of the creditor for record retention and Regulation Z compliance.

8. Q What is meant by "actual APR" and "annual percentage rate calculated in accordance with the Act," as used in the Policy Guide?

A Those terms mean the lowest permissible APR that can be computed, applying all applicable provisions of Regulation Z.

9. Q How will disclosures containing information properly estimated under 12 CFR 226.5(c), 12 CFR 226.17(c), and Appendix D be treated for reimbursement determinations and computations?

A If an APR or finance charge is in error for any reason other than a properly made estimate, the determination of whether the error constitutes a reimbursable overcharge will be made using the estimated information as disclosed. At the creditor's option, reimbursement will be based on either.

(1) The actual amount of loan advances, with consideration given to the amount and dates payments were actually made by the borrower; or

(2) The disclosed amounts of time intervals between advances and between payments.

The basis selected shall be applied, using the lump sum or lump sum/payment reduction method (at the creditor's discretion), to all loans of the same type subject to reimbursement.

10. Q Must a creditor use one reimbursement method consistently on all affected loans?

A No. The creditor's right to choose between the two methods applies to each transaction.

11. Q May a creditor apply a lump sum reimbursement to the consumer's loan balance instead of making a cash payment?

A The creditor must make a cash payment or a deposit into an existing unrestricted consumer asset account, such as an unrestricted savings or NOW account. However, if the loan is delinquent, in default, or has been charged off, the creditor may apply all or part of the reimbursement to the amount past due, if permissible under law.

12. Q If the transaction involves more than one consumer, to whom must reimbursement be made?

A The reimbursement is the property of, and is to be made to, the primary obligor in the credit transaction. If there is more than one primary obligor, reimbursement must be made jointly. If the primary obligor(s) is deceased, the payment should be made pursuant to the estate and escheat laws of the state. If the creditor is unable to locate the primary obligor(s), after having at least mailed the reimbursement amount to the consumer's last known address, the amount of the reimbursement is subject to the escheat laws of the estate.

13. Q Are the credit insurance provisions of the Policy Guide applicable to terminated loans?

A Yes. The credit insurance provisions apply if such loans originated within the Policy Guide’s corrective action period for terminated loans.

14. Q How will the Policy Guide apply if the cost of credit insurance premiums is disclosed as a rate (e.g., as a percentage or in dollars and cents per hundred per month) in a closed-end transaction?

A Regulation Z permits creditors to disclose credit insurance premiums on a unit-cost basis in closed-end transactions by mail or telephone under 12 CFR 226.17(g), and in certain closed-end transactions involving an insurance plan that limits the total amount of indebtedness subject to coverage.

In all other closed-end credit transactions, however, the dollar amount of insurance premiums must be disclosed. If the premium cost in those cases is disclosed as dollars or cents per hundred or as a percentage, it will be treated as if no disclosure of the cost had been made and the Policy Guide will apply accordingly.

15. Q How will the Policy Guide apply if a creditor does not include premiums for credit life, accident and health insurance in the APR or finance charge disclosures and fails to disclose the optional nature of the insurance, but has afforded the borrower the option of taking or refusing the insurance by checking a block or initialing a line opposite a statement similar to the following, both of which are disclosed in writing to the borrower: “I desire credit life, accident and health insurance" and "I do not desire credit life, accident and health insurance?"

A In those cases, the Policy Guide will apply because the creditor has not disclosed to the customer in writing, as required by Section 226.4(d)(1)(i) of Regulation Z, that the credit life, accident and health insurance are optional.

16. Q How will the Policy Guide apply if:

    (1) The consumer is charged for credit life, accident and health insurance premiums; and

    (2) The creditor did not include the premiums in the APR or finance charge disclosures; and

    (3) The creditor disclosed the optional nature and cost of credit life insurance to the consumer in writing and the customer signed or initialed close to those disclosures; and

    (4) Either no affirmative statement indicating a desire to obtain the insurance was provided or the appropriate box or line was not checked or otherwise marked to indicate whether the customer did or did not desire the insurance?

    A If the disclosure provided a choice to the customer through statements such as "I desire the insurance" and "I do not desire the insurance," and neither choice has been marked to designate the customer's selection, the Policy Guide will apply because the creditor did not meet the requirements of 12 CFR 226.4(d)(1)(iii).

    If no affirmative statement indicating a desire to purchase the insurance has been provided, and the customer has only signed or initialed near the optional nature statements or cost disclosures, the Policy Guide will apply because the creditor did not meet the requirements of 12 CFR 226.4(d)(1)(iii).

17. Q How will the Policy Guide apply if:

    (1) The creditor does not include premiums for credit life, accident and health insurance in the APR or finance charge disclosures; and

    (2) The creditor provides disclosures stating that the insurance is not required; and

    (3) The creditor provides the cost of each type of insurance, with a statement that the customer's signature will indicate a desire to purchase the insurance listed below and the customer signs once, below the cost disclosure, but does not initial each type of insurance desired?

    A If the disclosures clearly indicate that the customer, by signing where indicated, elects to purchase each type of insurance for which the cost has been provided, the Policy Guide will not apply. However, prospectively the creditor shall clarify such disclosures, by obtaining the customer's initials for each type of insurance selected, or by changing the manner in which the customer signs for credit insurance when more than one type is offered.

18. Q If a creditor has failed to reflect private mortgage insurance premiums in the APR or finance charge disclosures, may the institution cancel the insurance after it first reimburses the customer with a lump sum payment to cover the period up to the date of the reimbursement?

    A The creditor may elect to cancel the insurance if the quality of the asset is maintained and applicable laws and regulations are not violated. The effect of canceling the insurance will be to reduce the amount of the customer's future payments, as permitted by the "lump sum/payment reduction" method of reimbursement.

19. Q If the creditor failed to include any component of the finance charge (e.g., a loan origination fee) in the APR or finance charge disclosures, may the amount of reimbursement be reduced to account for fees excludable from the finance charge under 12 CFR 226.4(c) which are paid for by such finance charge components?

    A If the borrower has not otherwise paid such excludable fees (e.g., title insurance fees) to the creditor or to a third party, reimbursement may be computed after first deducting from the finance charge those fees qualifying under 12 CFR 226.4(c).

20. Q How will the Policy Guide apply if a creditor did not provide required disclosures to the consumer before consummation, but did supply them after consummation?

    A If required disclosures were not provided before consummation of the transaction, the transaction will be viewed as having no APR disclosed and the Policy Guide will apply. If the creditor's failure to provide disclosures included the credit life and accident and health insurance disclosures, the insurance premiums must be treated as finance charges.

21. Q Will the Policy Guide apply when a creditor has disclosed the APR as "2% OP," to mean a fluctuating rate of two percent over the prime rate, or has disclosed similar prime rate terminology instead of the APR?

A If the disclosure statement (not the note) clearly provides the numerical value of the prime rate as it pertains to the credit transaction, as of the time disclosures are given to the consumer, that rate (the prime rate or 2% OP) will be considered to be the disclosed APR under the Policy Guide. If the prime rate is not provided on the disclosure statement, the transaction will be viewed under the Policy Guide as if no APR has been disclosed.

22. Q How will the Policy Guide apply if a credit transaction has an interest rate or APR subject to increase and the variable rate feature was not provided on the disclosure statement?

A If the disclosure statement did not state that the rate would be subject to change, the borrower may be charged only at the original APR disclosed. Reimbursement under the Policy Guide will apply only to the period of time in which the borrower made payments at an increased rate.

23. Q How will the Policy Guide apply if a creditor disclosed that a rate will be prospectively subject to increase, but the APR disclosed or the finance charge disclosed or both were originally understated?

A The Policy Guide will apply as follows:

(1) If only the APR is understated, reimbursement will be required only for the period of time before the first scheduled change in rate under the variable rate feature in the contract.

The term "the first scheduled change in rate" refers to a date on which the rate will change to a level that is unknown or unpredictable at consummation. It does not include changes, such as step-rates, that are agreed upon before consummation.

For example, if the loan terms provide for a 9 percent rate for the first year and a 10 percent rate for the second year, followed by a variable-rate feature to be invoked at the beginning of the third year, reimbursement will apply only to the initial 24-month period. The lump sum/ payment reduction adjustment method may be used, using two payment streams for the initial two-year period. Payments after the 24th month would not be affected by the adjustment.

(2) If only the finance charge is understated, reimbursement generally will be required for a period covering the entire life of the loan, consistent with the options described in Q&A No. 6.

For example, if a loan origination fee was paid separately by the consumer at loan closing (making it a prepaid finance charge), and not included in the disclosed finance charge, the entire loan fee (less the applicable dollar tolerance) must be refunded as a "lump sum" payment.

If the loan fee was financed (included in the loan amount), the finance charge reimbursement may be prorated on a straight-line basis over the life of the loan and refunded under the lump sum/payment reduction method.

However, a finance charge adjustment will be required only for the period of time before the first scheduled change in rate if the error occurred solely because the interest component of the disclosed finance charge was based on either:

(a) The interest to be earned before the first scheduled change in rate, or

(b) The interest to be earned assuming an initial discounted rate over the life of the loan.

For example, the interest component of the disclosed finance charge might incorrectly reflect only loan interest for the first year on a transaction with variable-rate changes scheduled annually. Alternatively, it might incorrectly reflect interest calculated only at an initial discounted variable rate for the full term of the loan. In either case, if the loan terms in the example provide that the variable interest rate is subject to change annually, the finance charge reimbursement will apply only to the initial 12-month period.

The adjustment may be prorated on a straight-line basis over the life of the loan. Reimbursement of prorated amounts covering the period of time after the first scheduled change in rate (after month 12 in this example) would not be required.

(3) If both the APR and finance charge are understated, normally the lump sum finance charge adjustment is compared to the lump sum APR adjustment as of the loan maturity date and the larger adjustment determines which disclosure error is subject to reimbursement.

In the case of variable-rate transactions, however, the lump sum APR adjustment used for comparison is calculated for the period of time before the first scheduled change in rate in the manner indicated by (1) above and the finance charge adjustment is calculated in the manner indicated by (2) above.

For example, assume a loan in which both the APR and finance charge are understated on a 30-year, variable-rate loan that calls for rate changes annually. If both understatements were caused by the same failure to take into account a prepaid loan origination fee:

The APR reimbursement amount is the lump sum value for a 12-month period, which is determined by using the lump sum/payment reduction method and appropriate reimbursement tolerances

The finance charge reimbursement amount is the lump sum value for a 360-month period, which is determined by subtracting the appropriate reimbursement tolerance from the amount of the loan fee.

The APR adjustment is compared to the finance charge adjustment to determine the larger of the two. In the example, the finance charge adjustment (and not the APR adjustment) would be reimbursable.

24. Q If a creditor uses a simple interest rate, which is disclosed as the APR, to compute a monthly payment schedule, and the time interval from the date the finance charge begins to be earned to the date of the first payment is treated as if it were one month, even though that period is greater than one month and is not a "minor irregularity" under 12 CFR 226.17(c)(4), will the Policy Guide apply if the resulting application of the simple interest rate generates a higher finance charge than the one disclosed?

A The Policy Guide will apply if:

(1) The creditor's method used to compute the payment schedule, as previously described, is also used to compute the disclosed finance charge (i.e., the total of payments less the amount financed); and

(2) The final payment collected or scheduled under the contract (as generated by the application of the simple interest rate to the unpaid principal balance over the life of the loan) is greater than the one disclosed; and

(3) The finance charge resulting from the conditions described under (1) and (2) is understated.

25. Q Will reimbursement be required for demand loans with disclosures based on a one-year maturity when the demand loan contract calls for periodic payments that will amortize the loan over a definite time period?

A Yes. A formal amortization schedule recorded in the demand loan contract is, under 12 CFR 226.17(c)(5), equivalent to an alternative maturity date, and disclosures based on the amortization schedule should be made, as opposed to the one-year disclosure.

26. Q Will reimbursement be required on demand loans when:

(1) An alternate maturity date is disclosed and reflected in the contract, but the finance charge disclosure is based on one year?

(2) There is no alternative maturity date disclosed or reflected in the contract, but the finance charge disclosure is based on a period of time less than one year?

A In the first case, since there is an alternate maturity date in the instrument, which is disclosed, the finance charge disclosure should have been based on that alternate maturity date, as required under 12 CFR 226.17(c)(5), not on the disclosure period to be used when the instrument has no alternate maturity date.

In the second case, the actual finance charge disclosures should have been based on a one-year period, as required by 12 CFR 226.17(c)(5), not on some period less than that required when the instrument has no alternate maturity date.

After considering appropriate tolerances, reimbursement will be required in both cases if:

(1) The disclosed finance charge is less than the actual finance charge for the initial required disclosure period; and

(2) The demand loan has been on the institution's books past the period for which finance charge disclosures were made.

Reimbursement will be calculated for the required disclosure period only. The amount reimbursed to the consumer is the difference between the finance charge actually paid and the finance charge disclosed (which may be increased by the applicable finance charge reimbursement tolerance).

If the demand loan has not been on the institution's books past the period for which finance charge disclosures were made (e.g., the finance charge was disclosed for a one-year period, but should have been disclosed for a five-year period, and only 10 months have elapsed), no reimbursement is required. However, if the institution takes no prospective corrective action (i.e., if it does not at least disclose in writing a refinancing of the original loan) and the loan remains on the institution's books past the period for which the original finance charge disclosures were made, reimbursement will be required as previously indicated.

Those concepts apply both to straight and variable rate demand loans whenever the disclosed finance charge is less than the actual finance charge after considering appropriate tolerances.

27. Q Will reimbursement be required on demand loans when the variable rate feature has not been disclosed and the rate is increased?

A Yes. If the consumer has not been notified in writing of the rate change on or before the date of the change, reimbursement will be required if the financial institution has not made the variable rate disclosures.

Each time the rate is changed and the customer is not given written notification of the new rate, the rate change period(s) will be treated as if no APR had been disclosed, and the Policy Guide will apply. The rate on the most recent notification will serve as the contract rate.

28. Q How will the Policy Guide apply to residential mortgage transactions that have been assumed by a third party?

A Reimbursement will be made only to the original borrower and only to the extent of overcharges that occurred before the assumption if:

(1) A reimbursable violation is found on the original borrower's disclosure statement;

(2) The original borrower is not released from liability on the loan. The original transaction will be considered terminated with respect to the original borrower on the date of the assumption and the rules for application of the Policy Guide to terminated loans will apply.

Reimbursement will be made to the original borrower for the period before the assumption occurred if:

(1) A reimbursable violation is found on the original borrower's disclosure statement;

(2) The original borrower is not released from liability on the loan. However, in the event the subsequent borrower defaults and the original borrower must again assume payments on the loan, such payments will be based on the payment amount which would

have been calculated under the lump sum/ payment reduction method, at the time of reimbursement, had no assumption occurred.

If a required disclosure to a subsequent borrower contains reimbursable violations, that borrower shall be reimbursed for the period after the assumption occurred, based on the new disclosure.

29. Q What is the retroactivity period with respect to terminated closed-end loans if an institution elects to comply voluntarily with the restitution provisions of the Policy Guide, absent a current examination?

A The Policy Guide states that "for terminated loans ... an adjustment will not be ordered if the violation occurred in a transaction consummated more than two years prior to the date of the current examination." If an institution elects to comply voluntarily with the Policy Guide absent a current examination, the financial institution will have the option of either:

(1) Deferring reimbursement on any terminated loans until its regulatory agency conducts a current examination, or

(2) Reimbursing on any terminated loans falling within the two-year period prior to receipt of their regulatory agency's letter which gave the institution its option to make reimbursement.

30. Q If vendor's single interest (VSI) insurance is written in connection with a credit transaction, the insurance premiums are not included in the finance charge, and the creditor does not obtain a waiver of the right of subrogation from the insurer, is the resulting finance charge understatement subject to reimbursement under the Policy Guide?

A Yes. However, if the insurer has not exercised such right of subrogation and agrees to prospectively waive that right for outstanding loans, the Policy Guide will not apply to those loans.

31. Q If the finance charge is understated by more than the Policy Guide tolerance provided in the definition of understated finance charge, will reimbursement be required even though the understated finance charge is within the finance charge tolerance available under footnote 41 to 12 CFR 226.18(d)?

A No. Finance charge understatements that are within footnote 41 tolerances are not violations. Adjustments will be necessary, however, if the finance charge is understated by more than both the Policy Guide and footnote 41 tolerances. In these cases, actual adjustments may not take into account the disclosure tolerance of footnote 41.

32. Q How will the Policy Guide apply to violations of the early disclosure rules and Regulation Z?

A As a general rule, the Policy Guide will not apply to violations involving early Truth in Lending disclosures, but will apply to violations of the pre-consummation disclosures required by Section 226.17.

However, if the creditor has provided erroneous early disclosures and has not made pre-consummation disclosures, the Policy Guide will apply to the erroneous early disclosures.

33. Q How will the Policy Guide apply when loans subject to reimbursement are acquired through a merger, consolidation, or in exchange for the assumption of deposit liabilities, not including acquisition of a failed institution from a federal deposit insurer?

A In the case of a merger or consolidations, the receiving institution or the consolidated institution is liable for all liabilities of the merged or consolidating institutions, and the Policy Guide will apply.

In the case of loans acquired in exchange for the assumption of deposit liabilities, which does not involve a failed institution, the Policy Guide will apply to the original creditor.